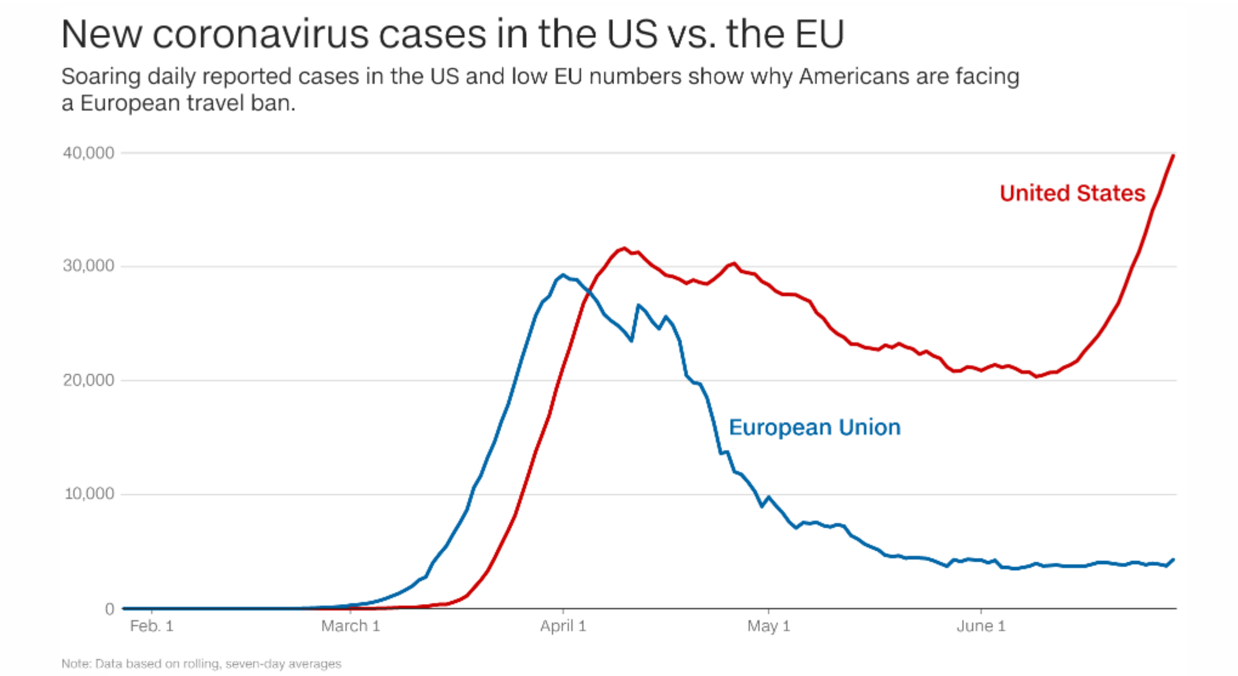
The most hated stock market rally in history has paused, but not halted, in the face of a resurgence in reported positive case counts in most of the U.S. It took 99 days from the known inception of the outbreak to reach a million cases, and much of the country was shut down for much of that period. It took just 43 days to record the second million cases, and the third million was reached in just 28 days as more areas have tried to reopen. This comes at a time when the EU, China, Taiwan, Canada, and other economies seem to be reopening with no measurable increase in new cases, so far.



Citing an increase in testing as a contributing factor in the rise in new cases is akin to blaming the scorekeeper for being behind in the game. The fact is that the ratio of positive outcomes is increasing significantly in most states, particularly in Florida and Texas, which together account for 15% of our GDP. California Governor Newsom has announced the re-closing of bars and indoor dining in his state, and has discussed closing beaches again, as well. California, which would be the fifth largest economy in the world if it were an independent country, accounts for an additional 15% of U.S. GDP. In all, new cases are accelerating in 37 states, and the cumulative effects of these new outbreaks on the economic recovery that the stock market has discounted is impossible to predict. The re-imposition of widespread lockdowns is probably not feasible, either politically or economically, but local public health measures could continue to have a negative impact. And the voluntary or reflexive actions of the populations in these hot spots, whether through self-isolation, worker absenteeism, or other behaviors, could easily dampen the recovery or lengthen the period it takes for the economy to return to normal. In any event, it's clear that the road to re-opening our states and cities will be long and difficult.

For now, the message from the market seems to be that, despite rising case counts, the economic upswing will continue, but at a slower pace than has been seen the last two months. Investors are also taking comfort from the apparent success of the Fed's response to the current situation compared to the 2008 recession. During the first phase of the latter crisis, broad liquidity measures did not grow at all even though the Fed more than doubled its balance sheet. In the current instance, from the pre-Covid period, the Fed's balance sheet is up by less than 70%, while bank deposits and broad measures of the money supply have increased by 18% and 25%, respectively.

The economic data continues to improve at a faster pace than was expected just a few weeks ago, though the numbers remain well below levels that would indicate a return to normalcy any time soon. The markets were buoyed by the June employment report that showed that the economy added 4.8-million jobs during the month, and the unemployment rate fell to 11.1%. Both numbers were better than expected for the second straight month, but the economy is still down nearly 14.7-million jobs since February, and the unemployment rate remains higher than at any point in the Great Recession. Millions of formerly productive workers and small businesses are still idle, relying on continued government assistance to make ends meet, but a portion of that assistance is set to expire on July 31 unless Congress acts to extend it. Finally, the Labor Department noted that, for the fourth consecutive month, its data collectors misclassified some workers as "employed not at work," when they should have been classified as "unemployed on temporary layoff." If these workers had been properly accounted for, the true unemployment rate would be 12.3%. It is also worth noting that most of the returning workers were those whose layoffs were temporary to begin with. We have yet to deal with the unknown number of jobs that will not be coming back to the businesses – large and small - that will not survive the pandemic.

The growing uncertainty over the sustainability of our recovery continues to drive investors to the mega-cap companies that dominate the S&P 500 Index, while much of the broader market remains depressed. Shares of Facebook, Amazon, Apple, Netflix, Google (Alphabet), and Microsoft are up an average of 74% from the March 23rd market low, and all except Google are trading at all-time highs. (Google is 1% below its high). These 6 stocks now comprise 25% of the S&P 500. Meanwhile, shares of the Financial Sector ETF remain 30% below their pre-Covid value, and other economically sensitive sectors have lagged as well. It's evident that equity investors are avoiding shares of companies whose outlook remains tied to the course of the virus, while betting heavily on growth companies regardless of valuation.

It would not be an overstatement to say that we are living through an unprecedented time both as investors in the financial markets, and in our daily lives. The challenge facing investors now is how to proceed in an environment where asset prices appear to be disconnected from the real economy, and the future course of the health crisis that precipitated these events is becoming more uncertain. The economic news so far has been encouraging, but is backward looking. After months of isolation and sacrifice, the future is even more in doubt. The range of possible outcomes at this point is still too broad to justify taking on additional risk in either the equity or credit market. Sometimes it is better to wait for the picture to clear and risk paying a higher price, than to buy early in the face of growing uncertainty. We think that now is one of those times.

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